the current level of interest rates by adding the recent average level of such rates to the equity risk premium.

As described above, Dr. Billingsley's quantitative evidence shows a zone of reasonableness of LEC cost of capital of 11.64%-11.82%. Qualitative factors and policy considerations that exist in today's market environment would support selecting a rate of return from the upward part of that range. These factors include the dramatically increased business risk confronted by LECs as manifested by the fundamental changes in the telecommunications industry, vigorous and growing competition, and regulatory risk and uncertainty.[109]

Further, the Clinton Administration has indicated its desire for a National Information Infrastructure, which will require massive investment by LECs and other members of the telecommunications industry. The need to spur required investment in the telecommunications infrastructure would justify selecting a rate of return from the upward part of the range of reasonable estimates. This will augment financial incentives to direct scarce capital dollars to infrastructure.

In sum, there is no basis for realigning downward the low end adjustment and sharing mechanisms. If anything, those mechanisms, to the extent retained, should be adjusted upward.

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109 See NYNEX at pp. 11-18, 32-35, Attachment B.

3. An Adjustment Of The Rate Of Return In This Proceeding Would Be Improper

Even if the Commission perceived a need to modify the 11.25% rate of return prescription - upward or downward - and, if downward, impose an associated one-time price cap reduction as well as realignment of the low end adjustment/sharing mechanism, such actions would be substantively and procedurally improper if undertaken in this proceeding.[110]

The issue set forth by the Commission for comment is "[w]hether the sharing and low-end adjustment mechanisms should be realigned with capital costs, and if so, how this should be done."[111] (Emphasis Added). No notice has been provided by the Commission regarding whether or how a one-time price cap adjustment should be made to reflect changed capital costs. NYNEX has addressed the "whether" issue by showing that no realignment of the low end adjustment/sharing mechanism with capital costs is warranted. But even if the Commission believes that realignment may be called for, the issue for comment is "how" this should be done. The most the Commission could determine in this docket is whether a further proceeding is needed to resolve the specific issues involved in effecting

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110 Notably, the Commission very recently decided to maintain 11.25% as the allowable rate of return component in its regulation of cable television providers. See Cable Television Rate Regulation, MM Docket No. 93-215, CS Docket No. 94-28, Order released March 30, 1994, at para. 207. There is no basis for disparate treatment of price cap LECs.

111 NPRM at para. 55.

a realignment.[112] Any other action would require prior notice to the public so as to afford due process and fair opportunity to be heard.[113]

Moreover, a one-time price cap reduction, as suggested by several parties,[114] would constitute retroactive alteration of the prescribed rate of return and low-end adjustment/sharing mechanism which in effect would recapture past productivity improvements. As shown below, this proposal is legally flawed and must be rejected.

The 11.25% interstate access rate of return was prescribed by the Commission pursuant to Section 205 of the Communications Act.[115] This rate of return was the maximum allowable return in the rates of price cap LECs set at the inception of price cap regulation.[116] Similarly, the Commission prescribed the low end adjustment and sharing mechanism maximum percentages - which are centered around the 11.25% rate of return - pursuant to Section 205 of the Communications Act.[117]

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112 GSA acknowledges that a further proceeding on rate of return would be necessary. GSA at pp. 4-8.

113 <u>See</u> Administrative Procedure Act, 5 U.S.C. Sections 552(a), 553(d).

114 <u>See</u>, <u>e.g.</u> AT&T, ARINC, CCTV, MCI.

115 47 U.S.C. Section 205. <u>See</u> <u>Rate of Return Order</u> at paras. 1, 7, 231; <u>NPRM</u> at paras. 48, 54 & n. 59.

116 <u>See</u> <u>LEC Price Cap Order</u> at para. 247; Section 65.1 of the Commission's Rules, 47 C.F.R. Section 65.1.

117 <u>LEC Price Cap Order</u> at paras. 128, 414; <u>LEC Price Cap Reconsideration Order</u> at para. 104. <u>See</u> also <u>LEC Price Cap Order</u> at paras. 7, 10 and n.6.

It is axiomatic that once a regulatory agency prescribes a maximum allowable rate, the rate cannot be lowered retrospectively so as to subject the carrier that charged that rate to refunds or reparations.[118] This "Arizona Grocery doctrine" was further explained by the D.C. Circuit in Nader v. FCC.[119] After finding that the Commission had prescribed an 8.5% rate of return for AT&T, the Court declared:

> The holding of Arizona Grocery is consistent with our holding that the Commission prescribed AT&T's rate of return. In that case, the Supreme Court held that once the ICC had prescribed a maximum rate, which by statute must be the maximum reasonable rate, it could not thereafter claim that a carrier's duly filed rate below the prescribed maximum was unreasonably high [284 U.S.] at 387-89....
>
> Similarly, although the Commission made AT&T's rate subject to an accounting and refund order, the Arizona Grocery doctrine protected AT&T from having to refund revenue collected on the ground that an 8.5% overall rate of return was unreasonably high.[120]

Therefore, the Commission cannot lower retroactively the maximum 11.25% rate of return nor associated percentages in the low end adjustment/sharing mechanism. Any alteration can only be prescribed with prospective affect in a subsequent

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118 Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co., 284 U.S. 370, 383-90 (1932). ("Arizona Grocery")

119 520 F.2d 182 (1975).

120 520 F.2d at 202. The Court also observed that: "Since the rate of return is one component of a charge, and the charges prescribed must properly reflect the allowable rate of return, the prescription of a rate of return is fully consistent with the prescription of charges." Id. at 204.

appropriate proceeding conforming to the requirements of Section 205 of the Communications Act.[121]

4. Reduction Of The Price Cap Index Would Be An Unwarranted Exogenous Change

The argument that price caps should be reduced to reflect the LECs' cost of capital constitutes a request for exogenous treatment of capital costs.[122] Such exogenous treatment would be inappropriate and, in any case, would first require the resolution of complex issues in a further proceeding.

Even if the Commission were to represcribe a lower interstate access rate of return, it would be improper to make a one-time rate reduction for price cap LECs. First, such an action would be fundamentally different from the adjustment ordered by the Commission at the inception of price cap regulation to reflect the prescribed 11.25% rate of return. The Commission had then just completed a full rate of return represcription proceeding while LECs were still under rate of return regulation. The Commission declared:

> Because the decrease in the allowed rate of return [from 12%] must be removed from the rates of LECs subject to price caps before allowing price caps to become effective, we will treat the rate of return represcription as an exogenous cost adjustment. In the companion item we adopt today, the rate of return represcription is scheduled to become effective January 1, 1991. Unless the represcription is treated as exogenous, LECs entering price cap regulation will be able to use the higher, pre-represcription rates as a

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121 *See* also Part 65 of the Commission's Rules.

122 GSA acknowledges this point. GSA at p. 6.

> base for their price cap rates. In order to ensure that the timing of our rate of return represcription does not disadvantage ratepayers of those LECs entering price cap regulation, we will treat the represcription as an exogenous cost decrease to PCI levels, thereby ensuring that price cap rates decrease.[123]

At the inception of price cap regulation, the Commission in effect treated all costs as exogenous by starting with rate of return regulation-based rates in effect on July 1, 1990, subject to adjustment.[124] However, price cap LECs are presently under price cap regulation, so that it is unnecessary to make an exogenous rate of return adjustment to initiate price cap rates; the "one-time" adjustment was already made one-time, on January 1, 1991. Such a change midstream in price cap regulation would amount to a completely improper reimposition of rate of return regulation.[125]

Furthermore, changes in capital costs are not on the Commission's list of items eligible for exogenous

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123 LEC Price Cap Order at para. 247. See also Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 2176, Supplemental Notice of Proposed Rulemaking released March 12, 1990, para. 227: "had we been in a position to conclude a full-scale [rate of return] represcription earlier, there would have been no question that its effects would have been felt in the existing set of rates on which we based the indexes. We therefore tentatively propose to treat the effects of our Part 65 represcription decision as an exogenous adjustment to PCI levels."

124 See Docket 87-313 Supplemental Notice released March 12, 1990, supra, para. 225; LEC Price Cap Order at para. 230.

125 It is also noteworthy that the Commission has not readjusted AT&T's price cap plan to reflect changes in capital costs.

treatment.[126] Therefore, a request for exogenous treatment of a capital cost change would have to be carefully reviewed by the Commission to decide whether it should be allowed within the category of "other extraordinary exogenous cost changes as the Commission shall permit or require."[127] NYNEX submits that capital costs are neither extraordinary in nature nor have they changed extraordinarily. As the Commission has previously observed, "rate of return, the percentage expression of financing expenses, is just as real an expense ... as are wages and materials expenses."[128] Of course, wages and materials expenses are treated endogenously by the Commission, just like a wide range of factor costs.

A rate of return reduction should be deemed ineligible for exogenous treatment, just as the Commission has declined to treat depreciation rate changes as exogenous. Rate of return and depreciation are each prescribed by the Commission under Section 205 of the Communications Act. The Commission stated with respect to depreciation:

> We are required by the Communications Act to prescribe depreciation rates.... [W]hile we determine the rate of depreciation, we do not decide for carriers when to deploy new plant and when to retire the old. We believe that such decisions are at the very heart of a carrier's business operation, and we do not seek to disturb it. Accordingly, it is not this Commission, but the carrier, through its decisions on when to deploy and

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126 <u>See</u> Section 61.45(d) of the Commission's Rules, 47 C.F.R. Section 61.45(d).

127 47 C.F.R. Section 61.45(d)(1)(vii).

128 <u>AT&T -- Modification Of Prescribed Rate of Return</u>, CC Docket No. 79-63, 86 F.C.C. 2d 221 (1981), at para. 5.

> retire equipment, that primarily controls the rate at which plant investment is translated into depreciation expense. Based on this reasoning, we decline to give exogenous treatment to cost changes due to changes in depreciation rates.[129]

To the extent that a carrier controls depreciation rates, capital costs are similarly impacted by carrier decisions relating to when to issue and retire debt, when to issue and reacquire equity, the amounts of capital held, amounts of dividends, etc. Also, carriers' business plans and strategies impact investors' perception of risk, which affects stock valuation and determination of required rate of return. Accordingly, as depreciation has been treated as an endogenous cost by the Commission, so should rate of return.[130]

Moreover, exogenous treatment of rate of return would seriously dampen the incentives at the very heart of price cap

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129 LEC Price Cap Order at para. 182.

130 NYNEX notes that certain parties take inconsistent positions in this area. MCI offers a proposal to the Commission for "minimizing the number of cost categories that are accorded exogenous treatment." (MCI at p. 42). MCI suggests that the theory of exogenous treatment be restated to include only those Commission-ordered changes that result in a shift in costs between the interstate and intrastate jurisdictions or between regulated and non-regulated operations. Commission represcription of rate of return would not qualify for exogenous treatment under MCI's proposed test, for the represcription would just impact interstate regulated costs and rates. Accordingly, MCI is inconsistent in urging a one-time price cap reduction which amounts to exogenous treatment of a rate of return change. Further, CCTV (at p. 6) concedes that LECs impact capital costs by issuing or refinancing debt. Yet CCTV asserts (at p. 7) that interest rate changes are outside LECs' control. CCTV's concession on control supports endogenous treatment of rate of return.

regulation for carriers to be more productive and efficient. The Commission should act to maintain those incentives. For carriers to have to change service rates to flow to ratepayers the changes in capital costs would defeat that purpose.

If, however, the Commission were to view capital cost changes as eligible for exogenous treatment, and provide for a one-time price cap adjustment and/or realignment of the low end adjustment/sharing mechanism, the Commission must ensure against double-count of those changes in the GNP-PI factor of the price cap formula. AT&T acknowledges that appropriate adjustments would be necessary to avoid any double-count.[131] A further proceeding would be needed to resolve this complex issue.[132]

VIII. PROPOSALS TO CURTAIL THE ALLOWABILITY OF EXOGENOUS COSTS SHOULD NOT BE ADOPTED

Several parties propose that the Commission significantly scale back its recognition of exogenous costs in the price cap formula.[133] These proposals are asymmetrical, unfair to LEC shareholders and contrary to the incentive basis of price cap regulation. Therefore they should be rejected by

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131 See AT&T at 32-33 & n. 45, Appendix E.

132 Compare with the Commission's proceeding on cost changes resulting from a change to accrual accounting for postretirement benefits other than pensions ("OPEBs"), cited in NYNEX's Comments at n.139. OPEBs Order, 8 FCC Rcd 1024 (1993). In that proceeding, detailed evidence was presented and passed upon by the Commission relative to the issue of potential double-count of the cost changes in GNP-PI.

133 Ad Hoc, ICA, MCI, OCCO.

the Commission. Moreover, the request by AT&T and MCI for exogenous treatment of LEC amortized equal access reconfiguration costs should also be rejected as fundamentally inconsistent with well-established Commission precedent.

Ad Hoc, relying upon the ETI Study, proposes that price cap LECs be allowed exogenous treatment for only those costs that result from regulatory actions uniquely and specifically affecting LECs, such as jurisdictional cost shifts (between the state and federal books) and certain accounting changes such as expiration of amortizations.[134] ETI states that "LECs are entitled to no more protection than would be any firm operating under competitive conditions."[135]

The ETI proposal is conceptually flawed. ETI proposes that exogenous treatment of costs for LECs be comparable to how nonregulated firms in competitive industries may pass on costs in their rates. However, when addressing other aspects of the LEC price cap plan, ETI would maintain vestiges of rate of return regulation which constrain LECs unlike those nonregulated firms. Notably, nonregulated firms in competitive industries are not constrained by the tariff filing, earnings, productivity, and pricing bands rules governing the price cap LECs. Comparable treatment, then, would be to allow LECs to decide whether to reflect exogenous cost changes in their prices.

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134 Ad Hoc at p. 25; ETI Study at p. 79.

135 ETI Study at p. 81.

In addition, contrary to ETI's suggestion, exogenous cost treatment for the price cap LECs does not automatically mean costs are "passed through" in rates for service; after prior Commission review and approval exogenous cost treatment simply increases the PCI. The LEC can choose to price below the cap and not increase rates. This was the case in NYNEX's 1994 Annual Tariff Filing, for example, in which the proposed July 1, 1994 rates are approximately $35 million, on an annualized revenue basis, below the allowed cap. In this connection, ETI ignores the growing competition facing LECs, which constrains their ability to increase rates for service.

ETI also ignores the fact that AT&T has made upward adjustments in respect of exogenous costs.[136] Since AT&T is a competitive firm operating in the same industry, there should be an evenhanded basis to the exogenous adjustments AT&T is allowed compared to the exogenous adjustments price cap LECs are allowed. The fact that AT&T is including positive exogenous adjustments in its price cap filings[137] is also contrary to ETI's argument that competitive firms plan and

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136 Indeed, AT&T, as well as other interexchange carriers have increased rates for service. See The New York Times, May 22, 1994, "Viewpoints".

137 AT&T's price cap filing of May 17, 1994 included a positive exogenous adjustment for SFAS 112 of $231.11 million, and $3.23 million for Regulatory Fees. Prior AT&T filings included positive adjustments for SFAS 106 and Telecommunications Relay Service.

manage for such costs and "figure out a way to absorb them, work around them, or suffer a short-run earnings decrease."[138]

Furthermore, ETI would generally exclude from exogenous treatment cost changes associated with accounting changes.[139] NYNEX demonstrated, however, that such a reduction in permitted exogenous costs would be inappropriate.[140] Among other things, the treatment of exogenous cost changes should not turn upon a distinction between accrual versus cash basis accounting. The Commission has previously observed that "[a] change in accounting treatment may produce substantial changes in carrier costs" and likened such changes to jurisdictional separations changes,[141] which are clearly permitted as exogenous adjustments.[142]

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138 ETI at p. 81. ETI also suggests that interest apply where the LEC does not propose a downward exogenous adjustment that is subsequently required by the Commission (ETI at p. 82). Before any such proposal could be adopted, there would have to be a clear understanding of what was required for exogenous adjustments. Additionally, there would need to be a reciprocal provision that if upward exogenous adjustments are approved by the Commission, or by a court, interest will be applied to compensate the price cap LECs for any delay in the adjustment due to the regulatory process.

139 ETI states (at p. 78): "The exogenous cost standard should be limited so as to exclude all but those economic cost changes that are directly attributable to well-defined regulatory actions affecting local exchange carriers specifically and uniquely." See also ICA at n. 6; OCCO at p. 10.

140 NYNEX at pp. 62-65.

141 Price Cap Further Notice, 3 FCC Rcd 3195, 3424 (1988).

142 See Section 61.45(d)(1)(iii) of the Commission's Rules.

ETI's proposal is also far from being evenhanded. Thus, while ETI opposes exogenous treatment for such accounting changes as represcribed depreciation rates and the change to accrual accounting for OPEBs pursuant to SFAS 106, ETI proposes that exogenous adjustments be required whenever a Commission-approved amortization has expired, such as the expiration of depreciation reserve deficiency amortizations ("RDAs").

The asymmetry of ETI's position is readily apparent. ETI proposes requirements for price cap decreases (such as expiration of amortizations) but not increases. ETI fails to recognize that the Commission's price cap system contemplates that LECs are entitled to exogenous adjustments in order to avoid "unreasonably high or unreasonably low rates" which could result from treating various changes beyond carriers' control as changes in the carriers' level of efficiency.[143] Plainly, it would be inconsistent with the theory of price caps to only recognize downward exogenous adjustments and not upward adjustments.[144]

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143 <u>See</u> <u>NPRM</u> at para. 60.

144 ETI also argues that there is an intrinsic bias in the process of identifying and adjusting for exogenous cost changes. As purported illustration, ETI asserts that the GDP-PI includes an average of cost increases and decreases, and that allowing exogenous treatment for such changes as state tax changes provides a windfall increase for the LEC, since the GDP-PI also includes adjustments for tax increases in other states that do not impact the LEC (ETI at p. 80). However, ETI has failed to recognize that the majority of exogenous adjustments to date have been decreases, and that access charges have shown an overall downward

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MCI offers a plea for "minimizing the number of cost categories that are accorded exogenous treatment."[145] MCI would allow "only those Commission-ordered changes that result in a shift in costs between the interstate and intrastate jurisdictions or between regulated and non-regulated operations."[146] MCI's position is as deficient as Ad Hoc's. That is, MCI's proposals are one-sided, and would improperly penalize LEC shareholders by requiring them to absorb costs beyond the control of the carrier.

MCI also maintains that:

> [c]onsiderations of fairness require the Commission to specifically exclude future fee charges from exogenous treatment. Other segments of the telecommunications sector pay fees, and they have no mechanism for automatically passing them through to their customers.[147]

MCI's position lacks merit. These fees are beyond carriers' control. To disallow such government-mandated cost changes would penalize LEC shareholders.

Further, MCI's proposal would result in regulatory disparity inasmuch as other carriers are using the exogenous treatment process to reflect fees. For example, as noted, in

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144 (Footnote Continued From Previous Page)

trend since the inception of price cap regulation. <u>See</u> NYNEX at pp. 60-61 and n. 146. Therefore, any bias in the process of including exogenous adjustments, if anything, has been a bias toward downward adjustments.

145 MCI at p. 42.

146 <u>Id</u>.

147 <u>Id</u>. at p. 47.

AT&T's May 17, 1994 price cap transmittal to the Commission, which described the methodologies used to calculate adjustments to the PCI for each of AT&T's baskets, AT&T has included a $3.23 million exogenous cost adjustment to recover the Commission's new regulatory fees.

While AT&T does not propose to restrict further the recognition of exogenous costs, AT&T maintains that "the Commission should require exogenous treatment for ... fully amortized equal access network reconfiguration ('EANR') costs....[148] AT&T and MCI raised the same issue in the context of NYNEX's 1994 Annual Access Filing proceeding. NYNEX rebutted those parties in its Reply to petitions to suspend and reject the Annual Filing, Appendix A.[149] The Commission very recently released an Order rejecting AT&T's and MCI's contentions in that proceeding, stating:

> the Commission concluded in both the LEC Price Cap Order and the LEC Price Cap Reconsideration Order that all equal access costs are to be treated endogenously.... We believe that exogenous treatment of the EANR amortization would undercut the Commission's goal that the rates permitted under the price cap indices be driven by competition and market economies.[150]

An exogenous adjustment to reflect the expiration of EANR cost amortization is not warranted. In the LEC Price Cap

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148 AT&T at p. 46. See also MCI at pp. 47-48.

149 Since AT&T and MCI reiterate their arguments here, NYNEX presents a similar rebuttal in order to assure a complete record in this docket.

150 1994 Annual Access Tariff Filings, CC Docket No. 94-65, Order released June 24, 1994, paras. 54, 56.

Reconsideration Order, the Commission rejected an argument by MCI that the LECs should be required to make "a downward adjusted in PCI levels in 1994 to eliminate all equal access costs."[151] The Commission recognized that EANR costs would be fully amortized by January 1, 1994. However, under the price cap rules, exogenous treatment is not permitted for cost changes, such as EANR cost changes, that the Commission finds are within the LECs' control.[152] The Commission compared EANR costs to depreciation costs. Although depreciation costs are affected by the Commission-prescribed depreciation rates, the price cap rules do not give exogenous treatment to changes in depreciation costs because the Commission perceives the LECs to exercise control over such matters as the rate at which they retire equipment. Therefore, when equipment is fully depreciated, there is no PCI change. The Commission viewed the completion of equal access cost recovery similarly, and it rejected previous arguments by MCI to impose an exogenous change in 1994 for the expiration of EANR expense amortizations.

The Common Carrier Bureau confirmed the Commission's position on the treatment of EANR costs in the 1994 TRP Order.[153] In that Order, the Bureau rejected AT&T's request to include an exogenous adjustment in the 1994 Annual Access

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151 LEC Price Cap Reconsideration Order at para. 66 n. 77.

152 See OPEBs Order, 8 FCC Rcd at 1032-33.

153 Commission Requirements For Cost Support Material To Be Filed With 1994 Annual Access Tariffs And For Other Cost Support Material, Order released February 18, 1994.

Tariff Filings for the completion of EANR amortizations. The Bureau stated that the issue had been decided in the LEC Price Cap Reconsideration Order, and that "there is no requirement for price cap LECs to treat completion of amortization of equal access costs as exogenous...."[154]

AT&T argues that the Commission should require the LECs to reduce their price cap indexes because the indexes were initially established at a time when the LECs were still amortizing their EANR costs.[155] AT&T compares the EANR amortization to the expiration of the amortizations for inside wire and the depreciation reserve deficiency, which the Commission decided to treat exogenously.[156] However, in the LEC Price Cap Reconsideration Order, the Commission also decided not to allow exogenous treatment for the additional costs that the LECs would incur to implement equal access for pay telephones and to convert to four-digit carrier identification codes ("CICs").[157] Although the costs of these conversions were not embedded in the 1990 access rates that were used to initially establish the price cap indexes, the Commission declined to carve out exceptions to the requirement that equal access costs should be treated as endogenous.[158] Thus, the Commission took into account both

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154 Id. at para. 22.

155 AT&T at 47-48.

156 Id. at pp. 48-49 and n.82.

157 See LEC Price Cap Reconsideration Order at para. 65.

158 See id. at para. 66.

the existing EANR costs and the additional EANR costs that the LECs would incur in the future when it decided not to allow exogenous treatment.

Accordingly, AT&T's and MCI's request for exogenous treatment for the expiration of the EANR amortizations must be denied. If, however, those parties' request were to be granted, the Commission would have to reconsider the treatment of all equal access costs, including the equal access costs associated with pay telephones and CIC expansion.

IX. THE COMMISSION'S CURRENT SERVICE QUALITY MONITORING REGULATIONS SHOULD NOT BE MODIFIED

The Commission has in place an effective regime to monitor network reliability, service quality and infrastructure development. One party, TCA, suggests that the Commission's current service quality monitoring regulations are inadequate and should be expanded. TCA is incorrect.

TCA asserts that LECs should be required to provide exception reporting of "poorly performing wire centers and underserved areas."[159] This issue has been raised, unsuccessfully, by TCA on at least four previous occasions.[160] The Commission, after expanding the service

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159 TCA at p. 5.

160 *See* the following prior submissions by TCA: CC Docket No. 87-313, Petition For Reconsideration, November 19, 1990, Reply To Oppositions, January 8, 1991; DA 91-299, Comments on Public Notice, April 10, 1991, Application For Review, June 17, 1991, Reply To Oppositions, July 17, 1991; AAD 92-47, Comments, August 11, 1992.

quality reporting requirements to include a rural versus urban split in the data required, denied TCA's request:

> We will also not require further disaggregation, to wire center or NXX reporting levels, for several reasons. Such reporting would ... impose a large burden not only on the reporting LECs, but also on the Commission, both staff and facilities.... Further, it fails to meet the Commission's direction to find a balance between the usefulness of data and the costs of providing it. Absent any indication of service degradation, such detailed filing is not justified by the Commission's determination to monitor and evaluate representative service quality indicators.[161]

The Commission subsequently observed that there was no indication of degraded service under price cap regulation or of increased need for detail in wire center reporting.[162] Even TCA concedes that "there is no overall service quality degradation under price caps."[163] TCA does not provide any valid reason for the Commission to depart from its prior determination on this issue. The further disaggregated reporting as urged by TCA should therefore be rejected.[164]

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161 CC Docket No. 87-313, Order released May 17, 1991, para. 40.

162 AAD 92-47, Order released October 12, 1993, para. 12.

163 TCA at p. 2.

164 TCA also suggests that infrastructure development reports should be modified to provide for exception reporting of individual MSA or non-MSA areas that may lag behind in deployment of key technologies. TCA goes on to state that if an area appears on the report for more than four quarters, the LEC should be required to disclose its plans for deploying the technology needed to bring service up to par with the rest of its territory. (TCA at p. 8). Here again,

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In addition, TCA offers specific recommendations to expand the monitoring reports to include information concerning data transmission quality.[165] As with its other recommendations, TCA does not demonstrate that these additional reporting requirements will provide benefits that outweigh the costs and burdens these requirements will place on the LECs. TCA's recommendations should therefore be rejected. Nonetheless, should the Commission decide to adopt this TCA proposal, implementation of the rule change should be postponed. NYNEX uses the Centralized Automatic Report On Trunks system to conduct transmission testing. NYNEX currently performs testing for bit error rate and errored seconds for our 5E switches which are equipped with ISDN. Severe errored seconds monitoring and reporting are expected to be available in 1995 on our 5E switches. Testing for bit error rate and errored seconds on NYNEX's DMS switches should be available in the near term; expenditures in the range of $7 million need to be made before this testing capability can be developed. Accordingly, NYNEX could only provide at the current time a fraction of the data transmission reporting that TCA suggests. In all events, TCA's request for data transmission monitoring (bit error rate, errored seconds, etc.) should not be entertained by the Commission before NYNEX and other price cap

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TCA does not justify these proposals; they would add an unnecessary layer of detail to reporting requirements.

165 TCA at p. 9.

LECs can furnish this information for their entire networks, as opposed to a piecemeal basis.

X. NO REASON HAS BEEN DEMONSTRATED FOR ABANDONING THE 50/50 COMMON LINE FORMULA

In its Comments, NYNEX demonstrated that the "balanced 50/50 formula", which divides the benefits of increased per line usage of common line between the LECs and interexchange carriers, should be retained. Several parties argue that the Commission should instead adopt a per-line formula. These parties are incorrect.

Several parties argue that the balanced 50/50 formula should be abandoned because it has failed to encourage growth in common line usage.[166] As support for their position, they note that common line minute growth per line has been slower under price caps. It is not at all clear, however, that the balanced 50/50 formula is responsible for the decline in common line minute growth per line. Rather, it is far more likely that the economic recession is responsible for the decline in usage growth. Furthermore, any comparison of the pre-price cap period with the post-price cap period is inapposite because of the differences in the common line charge structure during the two periods.[167]

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166 AT&T at p. 27; MCI at p. 37. For example, AT&T points out that common line minute growth per line averaged 4.56% annually from June 1984 through December 1989, and 3.24% annually since the adoption of price caps.

167 During 1984 to 1989, the EUCL charge was increased while CCL rates declined, thereby providing an impetus for usage growth.

Several parties also suggest that the balanced 50/50 formula unduly minimizes the contribution that IXCs make to common line growth stimulation, while overstating the LECs' ability to do so.[168] These parties are incorrect. As the IXCs often note, LEC access charges are the single largest component of the long distance rates charged their customers. Lower access rates during the price cap period have clearly helped to stimulate usage.

The Commission "should be cautious regarding any changes in its original well-thought-out, balanced compromise."[169] A per-line formula for common line would eliminate the incentives to the LECs provided by the balanced 50/50 formula. It would also require a reduction of the productivity factor by at least 0.5%.[170] The Commission should retain the balanced 50/50 formula, and should also, with the growth of competition, permit price reductions below the maximum level produced by the CCL formula by class of service and geographic area. Finally, the Commission should remove NECA Long-Term Support ("LTS") from CCL rate development, and permit "bulk-billing" of LTS directly to the IXCs.

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168 MCI at p. 35.

169 ETI Study at p. 77.

170 In the initial price cap proceeding, the amount of the productivity factor attributable to common line was estimated at .51%.

XI. RULE REVISIONS TO GOVERN FOURTH QUARTER ACCOUNTING ADJUSTMENTS ARE UNNECESSARY

MCI suggests that modification to the price cap plan is necessary to "curtail the LECs' inclination to overstate their fourth quarter expenses."[171] MCI argues that the booking of large expenses in the fourth quarter "seems to be an attempt to manipulate the sharing rules,"[172] and that, to "check this behavior" the Commission should require that one-time accounting adjustments for the fourth quarter should be filed by September 15, accompanied by a full justification of each adjustment. Intervenors would then be given an opportunity to "suggest alternative ways to account for the expense."[173] MCI's arguments are without merit.

The Commission has previously rejected arguments that the Commission should look behind a LEC's reported earnings to decide whether a particular cost should be counted for the purpose of applying the low-end adjustment mechanism or sharing. As the Commission has stated,

> To attempt to determine which costs are related to potential "gaming" of sharing and low end adjustments would lead us down a path of determining which business expenses are legitimate attempts to improve productivity and which are not. There is no suggestion in the Commission orders

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171 MCI at p. 33.

172 Id.

173 Id. at p. 34.

> implementing price caps that this type of analysis is required.[174]

MCI has presented no argument that would warrant implementation of its proposal.

XII. CONCLUSION

Price cap regulation has helped to foster the Commission's goals of just, reasonable and nondiscriminatory rates, as well as a communications system that offers innovative, high quality services. While the existing price cap plan has provided significant benefits, fundamental reform of the Commission's price cap and access charge rules is required to achieve the Commission's policy goals in the years ahead. The Commission should reject the arguments of those parties that would have the Commission revise its price cap plan in a manner that would reduce incentives for LEC investment and continue the regulatory constraints that prevent LECs from meeting the access competition that is growing at a phenomenal rate. The Commission should instead adopt a pure price cap model to provide the price cap LECs with the investment and efficiency incentives necessary for them to participate fully in the development of the National Information Infrastructure. The Commission must also make a number of revisions to the plan in order to promote regulatory parity between the LECs and their competitors, most

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174 In the Matter of 1992 Annual Access Tariff Filings, CC Docket No. 92-141, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, released June 22, 1992, at para. 11.

importantly, significantly increase pricing flexibility for LECs subject to competition. By making these changes and the other changes to the rules proposed by NYNEX, the Commission will help to assure that all Americans receive the full benefits of competition.

Respectfully submitted,

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Dated: June 29, 1994